Supreme Court, U.S.
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In The

Supreme Court of the United States

ESTATE OF JAMES F. SHEPPARD, By Its Co-Personal Representative, Michael E. McMorrow,

Petitioner,

v.

JESSICA SCHLEIS, JAMES SCHLEIS, MARY JO SCHLEIS and XYZ FINANCIAL INSTITUTIONS,

Respondents.

On Petition For A Writ Of Certiorari To The Supreme Court Of Wisconsin

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Did the Wisconsin Supreme Court when interpreting the phrase . . . "at any time made a transfer . . . " as contained within section 2036 of the Internal Revenue Code improperly apply traditional concepts of Wisconsin property law by requiring a shifting of ownership *during the transferor's lifetime*, as a condition of section 2036 application *to P.O.D. accounts*, in the face of preemptive federal estate tax concepts, which deem incomplete transfers, being those transfers first taking effect at or after death, to be within the purview of section 2036?

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OPINION BELOW AND JURISDICTION

After granting a Petition to Bypass the Court of Appeals, the Supreme Court of Wisconsin ("state court") filed its decision on May 4, 2010 (App. 1-32) and entered an order denying Petitioner's motion for reconsideration on June 10, 2010. (App. 33-34)

This court has jurisdiction to proceed as the state court interpreted a federal statute (26 U.S.C. § 2036) and found the statute invalid as to P.O.D. accounts in that under Wisconsin's property law when a P.O.D. account is created, a completed lifetime transfer fails to occur.

The Supreme Court of the United States is now empowered to review as Federal law is as much the law of the several states as are the laws passed by their legislatures, with federal decisional law controlling on all questions of federal law. *Roden v. United States*, 55 F.3d 428 (9th Cir. 1995); *Haywood v. Brown*, 129 S. Ct. 2108, 2114 (2009). Moreover, the Federal Supremacy Clause of the Federal Constitution imposes on state courts a constitutional duty to proceed in a manner such that all of the substantial rights of the parties under controlling federal law are protected. See *Felder v. Casey*, 487 U.S. 131, 151 (1988), wherein a Writ of Certiorari was issued to the Wisconsin Supreme Court when Wisconsin law was in conflict.

As the state court has exercised jurisdiction **over federal law** (26 U.S.C. § 2036) this court is granted jurisdiction and federal cases will ultimately compel

the result. *Fitzgerald v. Racing Association of Central Iowa*, 539 U.S. 103, 106 (2003).[1] The exercise of jurisdiction by state courts over federal law is always *subject to two conditions*: "State courts must interpret and enforce faithfully the 'supreme law of the land' and their decisions are subject to review by . . . " the United States Supreme Court. *McKesson Corporation v. Division of Alcohol Beverages and Tobacco, Department of Business Regulation of Florida, et al.*, 496 U.S. 18, 29 (1990).

Additionally, any Wisconsin property law that is contrary to applicable federal law must yield. *Free v. Bland*, 369 U.S. 663, 666 (1962). In this case, the state court's interpretation of the phrase at " . . . any time made a transfer . . . " as contained in I.R.C. § 2036 is contrary to preemptive federal estate tax law, and consequently the Wisconsin Supreme Court decision under scrutiny will produce different outcomes based solely on whether the case is brought in state or federal court. *Felder v. Casey*, at 141; *McKesson Corporation v. Division of Alcohol Beverages and Tobacco, Department of Business Regulation of Florida, et al.*, 496 U.S. 18, 28 (1990).

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[1] In this case Federal cases have already compelled the result as the State Court relied on *Helvering v. Bullard*, 303 U.S. 297, 301 (1938) and *Hassett v. Welch*, 303 U.S. 303, 309 (1983). (App. 12) It is noteworthy that in both cases Section 2036's predecessors were found to embrace testamentary transfers with this Court relying on the Joint Congressional Resolution of March, 3, 1931 in both decisions.

Independently Congress has conferred jurisdiction as:

> "Final judgments or decrees rendered by the highest court of a state in which a decision could be had may be reviewed by the Supreme Court by Writ of Certiorari when the validity of a treaty or statute of the United States is drawn into question . . . " 28 U.S.C. § 1257(a)

Finally, state judicial orders are subject to review under Article III of the Constitution when, as here, federal questions are raised and proper steps are taken to that end in the United States Supreme Court. *District of Columbia Court of Appeals v. Feldman*, 460 U.S. 462, 479 (1983).

After deciding a *federal question*, the Wisconsin Supreme Court's decision is in conflict with *pre-emptive* federal estate tax law as:

1. Under federal estate-tax law, both complete and *incomplete transfers* are embraced by I.R.C. § 2036 and therefore, contrary to the state court's opinion, a transfer of ownership during the decedent's lifetime *is not required*, in that **transfers taking effect at death** are specifically included. *United States v. O'Malley*, 383 U.S. 627, 630-634 (1966); including Footnote 4; and,

2. The Wisconsin Supreme Court has rejected the federal rule of law as expressed in *Sulivich v. Commissioner*, 587 F.2d 845 (6th Cir. 1978), in which the Sixth Circuit applied § 2036 to *totten trust*

accounts. As *totten trust accounts* are *identical* to P.O.D. accounts, the Wisconsin Supreme Court's decision again conflicts with federal estate tax law. *McCarthy v. Bank of Fredonia*, 14 Kan. App. 2d 552, 795 P.2d 940 (1990); and,

3. The United States Board of Tax Appeals has ruled that a beneficiary's *survival* may be a "condition precedent" to the vesting of a property interest, opining " . . . that the law does not preclude the creation of interests in personal or real property *which are contingent upon the happening of a future event*, . . . ," which is what occurs when a P.O.D. beneficiary is designated as the beneficiary must generally survive the depositor, a circumstance found fatal to § 2036 application by the state court. *Estate of William B. Field, Petitioner v. Commissioner of Internal Revenue*, 22 B.T.A. 915, 919 (1931); and

4. The state court also rejected Federal Tax Law, as the term "transfer" is to be construed broadly and includes the relinquishment of any valuable right, which in this case was the relinquishment by Sheppard of his absolute ability to transfer 3.8 million dollars in assets by Last Will and Testament, or through an intestacy process to someone other than Jessica Schleis. *Doerr v. United States*, 819 F.2d 162, 164 (7th Cir. 1987); and,

5. By requiring, at P.O.D. account creation an inter-vivos transfer as a condition precedent to the application of section 2036, the state court improperly implemented traditional concepts of Wisconsin's

property law which conflict with acknowledged *preemptive* federal estate tax law concepts, *United States v. Heasty*, 370 F.2d 525, 528 (10th Cir. 1966). (App. 9-10)

Additionally, a conflict between two state courts has been created in that Kansas recognizes that upon P.O.D. beneficiary designation, the beneficiary is granted an executory claim as a third party beneficiary, while Wisconsin fails to recognize the transfer of this entitlement upon P.O.D. account creation. *McCarthy v. Bank of Fredonia*, supra at 944; Supreme Court Rule 10(b).

In the end analysis, the Wisconsin Supreme Court Decision primarily rests on federal estate tax law (I.R.C. §§ 2207B/2036) which when applicable, preempts state law and as a result, the United States Supreme Court has jurisdiction to review. *Hawaii v. Office of Hawaiian Affairs*, 129 S. Ct. 1436, 1442 (2009).

FEDERAL STATUTES INVOLVED

The operative federal provisions are contained in I.R.C. §§ 2207B, and 2206. These sections provide:

> "26 U.S.C. § 2207B – **Right of Recovery When Decedent Retained Interest:** (1) In General – If any part of the gross estate on which tax has been paid consists of the value of property included in the gross estate by reason of section 2036 (relating to transfers with retained life estate), the decedent's

estate shall be entitled to recover from the person receiving the property the amount which bears the same ratio to the total tax under this chapter which has been paid as –

A. The value of such property, bears to

B. The taxable estate."

"26 U.S.C. § 2036 – **Transfers with Retained Life Estate:**

(a) General Rule – The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has ***at any time*** *made a transfer* (except in the case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust *or* ***otherwise***, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death –

(1) The *possession* or *enjoyment* of, or the *right to the income* from, the property, or

(2) The right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom." (*emphasis supplied*)

STATEMENT OF FACTS

James F. Sheppard created two (2) P.O.D. accounts, one being a brokerage account at the M&I Brokerage Services, Inc. and the other being a premier platinum checking account at the Chase Bank located in Germantown, Wisconsin. As of Sheppard's death, the M&I brokerage account had $1,115,720.44 on deposit and the Chase Bank account had $2,666,854.59 on deposit, for a total of approximately $3,800,000.00 (hereinafter referred to as the P.O.D. accounts). (App. 5, 6, 47) The federal estate tax allocable to these two accounts is $1,231,200.00. (App. 47) As of January 27, 2009 $444,597 of the federal tax had been paid. (App. 47)

Under Wisconsin law, P.O.D. accounts are deemed to be non-probate property, with Sheppard having the right to designate the remainderman, and with the asset transfer being completed or finalized at or after Sheppard's death without judicial or administrative confirmation. (App. 4)

During his life, Sheppard retained an "enjoyment" or ownership interest as he controlled the P.O.D. accounts, which entitlement was measured by the term of his life. Sheppard died intestate on July 2, 2007.

Both at the initial pleading, as well as the trial court and state appellate court briefing stages, the Petitioner asserted that §§ 2207B/2036 of the Internal Revenue Code required that Jessica Schleis reimburse the Estate for all federal estate tax liability

incurred on the P.O.D. accounts. (App. 9, 10, 44) The Petitioner further asserted that federal law was preemptive. (App. 44)

The Estate's alternative inclusion of the Doctrine of Limited Equitable Apportionment was presented solely as the fallback position on the federal estate tax liability issue, to be considered for federal estate tax purposes, **if and only if,** §§ 2207B/2036 were for any reason held inapplicable. (App. 44) Specifically, the Estate argued in the state court as follows:

> "*In the event the federal statute is for any reason found inapplicable,* the Appellant requests the court to prevent the injustice to some heirs and a windfall to Respondent Jessica Schleis through the application of the doctrine of limited equitable apportionment to the P.O.D. accounts." (App. 37) (*emphasis supplied*)

The circuit court for Washington County, Wisconsin, in construing the Petitioner's complaint, wherein the application of I.R.C. §§ 2207B/2036 was requested with respect to the federal estate tax obligation, failed to specifically deal with the section 2036/2207B issue and granted summary judgment to the Respondent. (App. 29, 30)

On appeal, the Petitioner framed the federal issue as follows: "Does I.R.C. § 2207B require Jessica Schleis to reimburse the Estate for federal estate tax liability incurred on payable on death accounts?" (App. 36)

Here again, the Petitioner expressly stated that the State Doctrine of Limited Equitable Apportionment should be applied to federal tax liability *if and only if* the federal statute was for any reason found inapplicable. (App. 37, 44)

In deciding the federal question, the Wisconsin Supreme Court concluded that only one issue dealt with federal law, casting the inquiry as follows:

> "*The first issue* is whether the *Internal Revenue Code* provides the estate a right to recover a portion of federal estate taxes from the recipient of a P.O.D. account." (*emphasis supplied*) (App. 8)
>
> "To determine whether the P.O.D. accounts at issue were included in the gross estate under 26 U.S.C. § 2036, *we must determine* whether the decedent made "a transfer" *during his life* by *creating* the P.O.D. accounts." (App. 12)
>
> "*Under Wisconsin law* governing P.O.D. accounts, the creation of a P.O.D. account does not amount to a transfer of property by the decedent to the recipient during the decedent's life." (App. 12)
>
> The state court concluded that: "The P.O.D. accounts at issue do not fall within 26 U.S.C. §§ 2207B and 2036 or any other exception to the general rule that an estate pays the federal estate tax generated by nonprobate assets." (App. 4)

The state court further held:

> "A property interest *must be transferred during the owner's lifetime* in order for a life estate to be retained." (App. 13)
>
> "The depositor did not transfer any ownership rights or any rights to income *during his life*." (App. 13-14)
>
> **"There *is no transfer* to the recipient involved in the *creation* of a P.O.D. account *during the decedent's lifetime* as *required* by 26 U.S.C. § 2036."** (App. 14) (*emphasis supplied*)

In reaching the conclusion that §§ 2207B/2036 do not apply to P.O.D. account generated federal estate tax liability, the state court implemented *traditional Wisconsin property law* to decide whether the creation of a P.O.D. account and the designation of a beneficiary constitutes a "transfer" under § 2036, looking to Chapter 705 *Wis. Stats.* entitled "Non Probate Transfers at Death" to conclude that as ownership of the account was not immediately shifted by virtue of the designation of a P.O.D. beneficiary, the state court "required" lifetime transfer had failed to occur. (App. 12)

In so doing, the state court expressly rejected the federal court's broad definition of the word "transfer" as ruled in *Doerr v. United States*, 819 F.2d 162, 164 (7th Cir. 1987) which includes the relinquishment of any valuable right. (App. 14, Footnote 10) Here,

Sheppard gave up his absolute right to leave significant P.O.D. assets under his last Will and Testament, or by intestacy. In addition, the state court failed to consider that under federal estate tax law (section 2036) a transfer can also take effect at or after death.

The Estate filed a Motion for Reconsideration in the Wisconsin Supreme Court, relying on *United States v. O'Malley,* 383 U.S. 627 (1966). In responding to the Estate's Motion for Reconsideration, the Respondents have conceded that § 2036 does embrace *incomplete* transfers. (App. 40)

REASONS FOR GRANTING THE PETITION

A Writ of Certiorari should be granted in that:

I. **THE STATE COURT HAS INCORRECTLY DECIDED AN IMPORTANT QUESTION OF FEDERAL LAW THAT HAS NOT BEEN, BUT SHOULD BE SETTLED BY THIS COURT, WHICH IS: "DOES SECTION 2036 OF THE INTERNAL REVENUE CODE APPLY TO P.O.D. ACCOUNTS?" (SUPREME COURT RULE 10(c)).**

II. **BY REQUIRING AN INTER-VIVOS "TRANSFER" OF OWNERSHIP AT THE TIME OF CREATION OF A P.O.D. ACCOUNT, THE WISCONSIN SUPREME COURT APPLIED TRADITIONAL STATE PROPERTY-LAW CONCEPTS TO THE PHRASE, " . . . HAS AT**

ANY TIME MADE A TRANSFER . . . ," EFFECTIVELY REQUIRING A COMPLETED LIFETIME TRANSFER THUS CREATING THE CONFLICT AS FEDERAL ESTATE TAX LAW AS APPLIED BY THIS COURT DEFINES A "TRANSFER" AS INCLUDING AN "INCOMPLETE" TRANSFER, WHICH *IS TO TAKE EFFECT AT OR AFTER DEATH* – WHICH WOULD INCLUDE THE DESIGNATION OF A P.O.D. BENEFICIARY. *UNITED STATES v. O'MALLEY*, 383 U.S. 627, 631-634 (1966).

III. THE WISCONSIN SUPREME COURT'S DECISION RESULTS IN A SIGNIFICANT LOSS TO THE ESTATE IN THE AMOUNT OF ONE MILLION TWO HUNDRED THIRTY-ONE THOUSAND TWO HUNDRED TWENTY DOLLARS ($1,231,220.00) PLUS INTEREST. (APP. 47) THIS ECONOMIC LOSS IS TRACED DIRECTLY TO THE STATE COURT'S ERRONEOUS INTERPRETATION OF FEDERAL ESTATE TAX LAW AND THE INJURY TO THE PETITIONER CAN ONLY BE REDRESSED THROUGH A FAVORABLE DECISION BY THIS COURT. *ASARCO, INC. v. KADISH*, 490 U.S. 605, 619 (1989).

In four areas of federal estate taxation, to include I.R.C. §§ 2207B/2036, federal legislation has superseded state apportionment practices with a common thread among the four, being that they govern assets which are includable for federal estate tax purposes,

but like P.O.D. accounts " . . . are passing outside the hands of the estate's personal representative and without the supervisory jurisdiction of the probate court." As such, if there is a *conflict* between state law principles governing the payment of federal estate taxes . . . "the federal statute would control." See *First National Bank of Shelby v. Dixon*, 38 N.C. App. 430, 248 S.W. 2d 416, 418-419 (1978), supra; *Estate of King*, 52 Misc. 2d 1021, 277 NYS 2d 281, 286 (1967) wherein the court observed that it: " . . . would appear that §§ 2206 and 2207 of the Internal Revenue Code would be controlling . . . " and therefore preempt state law. See also state court's opinion (App. 10-11) ruling that if P.O.D. accounts are included in gross estate pursuant to section 2036, then section 2207B applies to the federal estate tax liability.

At issue then is whether §§ 2207B and 2036 of the Internal Revenue Code require the Respondent, as the *primarily* responsible party, to reimburse the Estate of James F. Sheppard for federal estate tax liability incurred on two (2) P.O.D. accounts, which never came into the hands of the Personal Representative.[2] Once again this determination focuses on the phrase " . . . has at any time made a transfer . . . " as contained in I.R.C. § 2036. Legislative history makes it clear that under Federal Estate Tax Law, transfers *taking effect at or after Sheppard's death* are included

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[2] Under federal law, the Petitioner and the Respondent have joint and several liability from the onset. 26 U.S.C. § 6324(a)(2).

within the term "transfer." See March 3, 1931 Joint Congressional Resolution found at Footnote 4, at 632, *United States v. O'Malley,* supra.

The Estate asserts that under federal estate tax law a P.O.D. beneficiary's primary responsibility for federal estate tax is not subject to debate, for this Court in *United States v. O'Malley*, 383 U.S. 627 (1966) ruled that it was federal " . . . legislative policy" to subject " . . . to tax *all property* which has been the subject of an *incomplete inter-vivos* transfer" and applied § 2036 to circumstances where the ultimate beneficiaries "enjoyment" was conditioned upon their " . . . surviving all named beneficiaries." (at 631-632 of *O'Malley* Opinion). Moreover, this court in *O'Malley*, supra, also applied § 2036 to those " . . . situations where the grantor *retained an interest in property* or its income, or a power over either, ***and*** *his death is a significant step* in *effecting a transfer which began inter-vivos*, but which *"becomes final and completed only with his demise."* (at 634 of *O'Malley* Opinion).

Contrary then to the Wisconsin Supreme Court's opinion, it is the transfer of the P.O.D. account first taking effect at death and not the creation of the account during life that mandates the application of section 2036 to P.O.D. accounts. Clearly, the act of naming a P.O.D. beneficiary is, in fact, the commencement of a "transfer" during life which is completed only at the death of the depositor, being intended to take effect at or after

death; or otherwise stated, is an incomplete transfer of a property interest which had begun inter-vivos.

Moreover, the federal court has ruled that the application of § 2036 is to be governed by *federal estate tax concepts* and not by traditional concepts of property law, and when the state court's definition of a "transfer" conflicts and is inconsistent with federal estate tax law found in section 2036, a Writ of Certiorari is appropriate. *United States v. Heasty,* supra at 528; *Felder v. Casey,* 487 U.S. 131, 138 (1988).

Traditional concepts of property law do require a complete shifting of ownership to constitute a transfer. As for example, BLACK'S LAW DICTIONARY, 1503 (7th ed. 1999) defines a "transfer" as being a "conveyance of property or title from one person to another." Furthermore, under Wisconsin Estate Law a "transfer" means the passing of property. *Wis. Stats.* § 72.01(21). However, as to the *timing* thereof, a transfer can occur *both* during the lifetime of the transferor or by reason of the transferor's death. *Wis. Stat.* § 700.01(7). As such, the ultimate question is, when under section 2036 must the transfer be effective?

On this issue, it is decisive that an incomplete lifetime transfer, which takes effect at death, is unequivocally recognized in a basic legal publication as being within the purview of section 2036 as BLACK'S LAW DICTIONARY, 1504 (7th ed. 1999) instructs as follows:

> "**Incomplete transfer.** Tax. A decedent's inter-vivos transfer that is not completed for Federal Estate – tax purposes because the decedent retains significant powers over the property's possession or enjoyment.
>
> Because the transfer is incomplete, some or all of the property's value will be included in the transferor's gross estate. I.R.C. (26 U.S.C.A.) §§ 2036-2038."

It is also significant that on March 13, 1931, by Joint Congressional Resolution, the legislature applied section 2036 expansively stating that it encompasses *both* completed inter-vivos transfers, *as well as to transfers which only take effect at death.* More specifically, this court in *United States v. O'Malley,* supra, observed that:

> "On March 3, 1931, the s 302(c) of the Revenue Act, of 1926, was amended by joint resolution to read as follows:"
>
> To the extent of any interest therein of which the decedent has *at any time* made a transfer by trust or *otherwise* in contemplation of or *intended to take effect* in possession or enjoyment *at or after his death,* ***including*** a transfer, under which the transferor has retained for his life or any period not ending before his death (1) the possession or enjoyment of or the income from the property . . . " is to be within the definition of section 2036. See *United States v. O'Malley,* 632, Footnote 4 (*emphasis supplied*).

Notably, a transfer made "otherwise" is *accomplished in a different way or manner*, and includes the creation of a P.O.D. account. Webster's Third New International Dictionary, 1976 G. & C. Merriam Co., at 1598.

In this analysis, the ultimate question is the application of the word "transfer" as used in section 2036 *and when the transfer must occur*. Once again, *United States v. O'Malley* supra at 633-634 is instructive as this court recognized section 2036's applicability to transfers " . . . not incomplete in any respect" *as well as to* " . . . those situations where the grantor retains an interest in the property . . . " and the transfer is not completed until his demise. Clearly, section 2036 envisions a "transfer" occurring *at one of two points in time*, the *first* with a completed transfer being made during lifetime and the *second* being a transfer, which only takes effect at or after death. As the Supreme Court of Wisconsin limited section 2036's application to completed inter-vivos transfers, looking only to what occurs at the P.O.D. account's creation, the state court failed to correctly interpret Federal Estate Tax Law causing section 2036 to be invalid.

Important here is that the state court's utilization of traditional property law concepts when construing I.R.C. § 2036 was rejected by the federal court in *United States v. Heasty*, 370 F.2d 525, 528 (10th Cir. 1966). In *Heasty*, supra, the Tenth Circuit when analyzing the circumstances presented in *United States v. O'Malley*, supra, opined that the settlor was for federal estate tax purposes *deemed to*

be the "owner" of future income " . . . since the *federal estate tax law disregarded* his original transfer of the property to the trust." (See at 528 of *Heasty* Opinion.)

In its analysis, the Tenth Circuit states:

> "It cannot be doubted that the Supreme Court (in *O'Malley*) *did reject the traditional concepts of property law* and applied a federal estate tax concept." (at 528) (*emphasis supplied*).[3]

The Wisconsin Supreme Court has imposed a substantial injustice upon the Estate as well as the eight (8) non-resident heirs. This injustice is in the form of the taking of One Million Two Hundred Thirty One Thousand Two Hundred Twenty Dollars ($1,231,220.00) of estate assets being accomplished by the state court improperly requiring that to constitute a "transfer" under section 2036, an ownership interest must be shifted to the P.O.D. beneficiary *during the transferor's lifetime.*

Clearly, a named beneficiary of a revocable trust does not receive an ownership interest during the settlor's lifetime. However, when the trust settlor also retains rights to trust income, section 2036 is held to apply. *Burke v. Cleland*, 702 N.E.2d 1078, 1081 (Ind. Ct. App. 1998).

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[3] It is noteworthy that *United States v. Heasty* is not applicable on the merits as the case involved an attempted transfer of an asset which the transferor did not own.

Of equal significance is the fact that a P.O.D. account has no owner until it is created. A transfer occurs, albeit incomplete, upon account creation. It follows that a *life estate* was retained by Sheppard when he established the P.O.D. accounts. A life estate is synonymous with being a "life-owner" and is the equivalent of holding a "freehold estate." *In re Allen*, 415 B.R. 310 (N.D. Ohio 2009); BLACK'S LAW DICTIONARY 937 (7th ed. 1999). In this connection, the federal court has held:

> "The phrase "life estate" has a well-established meaning. It is an estate in land giving the life tenant full and exclusive possession of the property for the duration of the life tenant's life." *United States v. Baran*, 996 F.2d 25, 28 (2nd Cir. 1993).

In this case, the state court incorrectly ruled that the creation of a P.O.D. account does not constitute a transfer for the reason that the depositor remains the owner during his or her lifetime. (App. 13)

To the contrary, lifetime ownership is the very definition of holding a life estate. It is therefore clear that having ownership during life, being the retained interest, and making a transfer as defined under section 2036 are mutually exclusive, as they are separate and distinct factors.

As Sheppard held a life estate in the P.O.D. accounts, and as a "transfer" as defined under section 2036 occurred, section 2207B is applicable.

In summary then, this Petition for a Writ of Certiorari is based on controlling federal estate tax law being supported in part by the following:

First, I.R.C. § 2036 is to be applied to both completed as well as *incompleted transfers* of property interest as was made clear in *United States v. O'Malley*, supra at 631.

Second, I.R.C. § 2036 was intended by Congress to embrace testamentary transfers, i.e., intended to take effect at death. *United States v. Grace*, 395 U.S. 316, 324 (1969); *Hasslet v. Welsh*, 303 U.S. 303, 309 (1938); Joseph M. Dodge, "*Retentions, Receipts, Transfers and Accumulations of Income and Income Rights: Ruminations on the Post-Byrum Role of Estate Tax Sections* 2036, 2037, 2039 and 2043(a)," 58 Tex. L. Rev. No. 1, 3 and 10 (December 1979).

Third, I.R.C. § 2036 applies when, as with P.O.D. accounts, the eventual enjoyment of an asset is conditioned on the survival of a designated beneficiary. *United States v. O'Malley*, supra at 631; *Sulivich v. Commissioner*, supra at 848.

Fourth, I.R.C. § 2036 language which provides " . . . at any time made a transfer" has but one meaning – that being *a transfer made at any time*, including transfers which take effect at death. *United States v. O'Malley*, supra, Footnote 4, 632.

Fifth, comparing the totten trust to the P.O.D. account is most instructive. In this respect, it is stated:

> "A **P.O.D. account** is a contract whereby funds are deposited in a financial institution *for the benefit of another* and are payable upon the death of the depositor to the named beneficiary. *The depositor retains control over the account.* Because the P.O.D. account is based on a contract, the beneficiary's claim to the proceeds of the account is founded on a **third-party beneficiary theory**.
>
> A **Totten Trust** is created by depositing funds in a financial institution as 'trustee' for certain named beneficiaries. The depositor can withdraw the funds or revoke the trust, and the beneficiary's rights to the trust funds arise only upon the depositor's death." (Citations omitted) The disposition of the funds upon the depositor's (trustee's) death from a *totten trust* is **identical** to that of a P.O.D. account, although a *totten* trust is based on trust principles rather than contract rights." (Citations omitted) *McCarty v. State Bank of Fredonia*, 14 Kan. App. 2d 552, 558, 795 P.2d 940, 944-945 (1990) (*emphasis supplied*).

P.O.D. accounts are identical to totten trust savings accounts (with totten trust accounts being based on trust principles and P.O.D. accounts being based on contract rules) and therefore federal estate tax law as set forth in *Sulivich v. Commissioner*, 587 F.2d 845 (6th Cir. 1978), requires the application of I.R.C. § 2036 to P.O.D. accounts as well.

Sixth, if, as with P.O.D. accounts, the transferor's relationship to the assets *remains the same after a transfer, as it was before a transfer*, i.e., ownership retained, the value of the assets may then be included in the transferor's estate under I.R.C. § 2036. *United States v. Grace*, 395 U.S. 316, 324 (1969); *Reichardt v. Commissioner of Internal Revenue*, 114 T.C. 144 (2000).

Seventh, notwithstanding the state court's opinion, as P.O.D. account creation is predicated on contract principles, Jessica Schleis was, upon beneficiary designation, immediately transferred a property right – that being an entitlement to the account proceeds based on third party beneficiary principles, subject only to a condition precedent, i.e., that she was not replaced and that she survive Sheppard. *Estate of William B. Field v. Commissioner of Internal Revenue*, 22 B.T.A. 915, 919 (1931); *McCarthy v. State Bank of Fredonia,* supra at 945.

Eighth, this court in *United States v. O'Malley*, supra at 632, Footnote 4, observed that the predecessor to I.R.C. § 2036 was the 1931 Congressional response to *May v. Heiner*, 281 U.S. 238 (1930), which case held that trust income for life with the remainder interest passing to the children was not includable under I.R.C. § 2036. In response, by joint Congressional resolution, I.R.C. § 2036's predecessor was clarified and *expanded* to cover transfers *which are intended to take effect at death* by trust or *otherwise* wherein the transferor retained either possession, enjoyment, or income for life. Under federal

estate tax law, the term **enjoyment** is defined as being "all present economic benefit" which is, in fact, the life time ownership of the asset. *Carpenter Estate v. United States*, 73-C-42, 45 A.F.T.R. 2d 80 – 1784, 1785 (U.S. District Court, Western District of Wisconsin – 1980). As such, I.R.C. § 2036 clearly applies to P.O.D. accounts established for the benefit of another (Sheppard) which are made at creation payable upon death to Schleis, being a transfer taking effect at death and transferred "otherwise."

Ninth, under § 2036, substantive estate inclusion issues should be resolved from the perspective of hindsight, rather to the gift-time form of the transfer. 58 Tex. L. Rev. 1, at 6, supra.

Tenth, subsequent to its Decision in *May v. Heiner*, 281 U.S. 238 (1930) when applying § 202(b), (a predecessor to § 2036), the Supreme Court of the United States has construed the progeny of 202(b) of the 1916 Act in an ***expansive manner***. Joseph M. Dodge, "*Retentions, Receipts, Transfers and Accumulations of Income and Income Rights: Ruminations on the Post-Byrum Role of Estate Tax Sections* 2036, 2037, 2039 and 2043(a)," 58 Tex. L. Rev. No. 1, 8 and 10 (December 1979).

As § 202(b) covered transfers *intended to take effect at or after death*, it is clear that I.R.C. § 2036 was likewise designed to capture *any testamentary transfer* taking effect at death or made at contemplation of death, which would include a P.O.D. account. *United States v. Grace*, 395 U.S. 316, 320 (1969).

Eleventh, the state court ruled that under Wisconsin law a transfer did not occur in part because the recipient must survive the depositor. (App. 16) To the contrary, the *O'Malley* Court applied I.R.C. § 2036 to any circumstance wherein the transferor retains the power to deny the beneficiaries the privilege of immediate enjoyment and/or to condition a beneficiary's "*ultimate enjoyment*" . . . "upon *surviving* the termination of the trust," with *conditional survival* being deemed the power to "designate," within the meaning of section 2036 – (then numbered § 831(c)(1)(b)(ii). (631 of *O'Malley* Opinion).

Other examples of federal decisional law supportive of the petitioner's contentions include the following:

A. Sheppard's right to control and his ability to remove all principal without notice to Schleis are authorized by I.R.C. § 2036, as Sheppard retained during his life time possession, income and enjoyment. This right to invade account principal equates to "enjoyment," meaning "all present economic benefit." – being a life time ownership equivalent. *Stafford v. United States,* 236 F. Supp. 132, 134 (E.D. Wisc. 1964); *Carpenter v. United States,* supra at 80-1785;

B. When a transferor *signed* an *unrecorded* deed naming his wife as transferee, and retained the absolute control over the property as well as the income generated therefrom, during his life time, he created under federal law a *life estate, while simultaneously* making the transfer expressly contingent

upon death and intended to take effect only at his death and therefore section 2036 applied. See *Wells Fargo Bank and Union Trust Co. v. United States*, 80 F. Supp. 787, 789-790 (1948);[4]

C. When a transferor held assets as a custodian for minor children but reserved the power to use the assets to discharge *his own* obligations of support, the Seventh Circuit concluded that I.R.C. § 2036 came into play, as during his life time he could use the funds, as if he owned them. *Estate of Prudowsky v. Commissioner*, 465 F.2d 62 (7th Cir. 1972);

D. When a decedent was able to use any or all of the funds on deposit in a savings account, as though they were his own, i.e., for his enjoyment, the account was included in his estate under I.R.C. § 2036. *Eichstedt v. United States*, 354 F. Supp. 484, 489 (N.D. Cal. 1972); and

E. In *Bowgren v. Commissioner of Internal Revenue*, 105 F.3d 1156 (7th Cir. 1997), the Seventh Circuit reviewed an Illinois land trust wherein the transferor continued to control the property, *exercised all rights of ownership*, held a personal property interest under Illinois Law, with the trustee having no duties other than as directed by the transferor.

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[4] Section 2036 of the Internal Revenue Code does not require that a separate life estate and remainder interest, as defined by state law be created. Rather, the plain language of § 2036 calls for the mere retention of "lifetime" ownership rights by the transferor.

Under such circumstances, the Seventh Circuit concluded that the retention by the transferor of the power to designate the ultimate beneficiary during her lifetime, causes *both* I.R.C. §§ 2036 *and* 2038 to apply. This rational is applicable to P.O.D. accounts, as both sections require a transfer, but are not limited in application to completed life time transfers. Here, Sheppard likewise retained the ability to designate the ultimate beneficiary.

In the final analysis, section 2036 is applicable to P.O.D. accounts as (1) section 2036 embraces incomplete transfers which start during life by virtue of a beneficiary designation and which first become effective at or after the creator's death and (2) the P.O.D. account creator retains a life estate in the account in that he or she is the owner of the account until death.

As the state court's decision to the contrary is inconsistent with preemptive federal estate tax law, this court is requested to exercise its discretion and grant the Estate's Petition for Certiorari, so as to correct a substantial injustice, as well as to settle an important question of federal law. *Felder v. Casey*, 487 U.S. 131 (1988), wherein a Writ of Certiorari was issued to the Wisconsin Supreme Court as Wisconsin's notice-of-claim statute was inconsistent and was preempted by federal civil rights law.

CONCLUSION

The basis for the Petition are (1) 26 U.S.C. § 2036 embraces both *inter-vivos transfers*, as well as transfers to take effect at death; (2) the Supreme Court of Wisconsin incorrectly utilized traditional property law concepts, rather than preemptive federal estate tax law, to conclude that a *completed inter-vivos* transfer is required to make section 2036 applicable to P.O.D. accounts; (3) on this federal question, a conflict exists between federal estate tax law as written and the state court's interpretation; (4) as a result a substantial injustice has occurred in the form of the wrongful taking of estate assets in the amount of One Million Two Hundred Thirty-One Thousand Two Hundred Twenty Dollars and No Cents ($1,231,220.00), plus interest; (5) P.O.D. accounts will continue to be implemented by United States citizens as an efficient non-probate transfer; and (6) it is highly probable that the imposition of a federal estate tax will continue going forward. Therefore the court should grant the Petition for a Writ of Certiorari and reverse the decision of the Wisconsin Supreme Court.

Respectfully submitted,

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2010 WI 32

NOTICE

This opinion is subject to further editing and modification. The final version will appear in the bound volume of the official reports.

No. 2009AP1021
(L.C. No. 2008CV1122)

STATE OF WISCONSIN : IN SUPREME COURT

Estate of James F. Sheppard, by its Co-Personal Representative, Michael E. McMorrow,

Plaintiff-Appellant,

v.

Jessica Schleis, James Schleis, Mary Jo Schleis and XYZ Financial Institutions,

Defendants-Respondents.

(Filed May 4, 2010)

APPEAL from an order and judgment of the Circuit Court for Washington County, Patrick J. Faragher, Judge. *Affirmed.*

¶1 SHIRLEY S. ABRAHAMSON, C.J. This is an appeal of an order and judgment from the Circuit Court of Washington County, Patrick J. Faragher, Judge. This court granted the Estate's petition to

bypass the court of appeals pursuant to Wis. Stat. §§ 808.05 and 809.60 (2007-08).[1]

¶2 Jessica Schleis was named as the recipient of two accounts, one a "Payable on Death" (P.O.D.) account, the other a "Transfer on Death" (T.O.D.) account, totaling over $3 million in the name of James F. Sheppard, the decedent. For ease of discussion, we will refer to both accounts as P.O.D. accounts.[2]

¶3 This action was brought by the Estate of James F. Sheppard, deceased, against the defendants, Jessica Schleis (the named recipient of the two accounts); her parents, James Schleis and Mary Jo Schleis (who signed an agreement with the Estate stating that "required estate taxes" would be paid out of the accounts); and XYZ Financial Institutions (named under Wisconsin's Fictitious Name Statute, Wis. Stat. § 807.12, as the institutions that currently have on deposit the funds from the two P.O.D. accounts). The Estate seeks reimbursement from these defendants of the federal and state estate taxes generated by the P.O.D. accounts.

¶4 The circuit court granted summary judgment to the defendants, holding that "the obligation to pay estate and inheritance taxes rests on the estate and the personal representative, not the defendants."

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[1] All subsequent references to the Wisconsin Statutes are to the 2007-08 version unless otherwise indicated.

[2] The two types of accounts are, for purposes of the instant case, substantially similar. *See* Wis. Stat. §§ 705.03(2), 705.26.

As to the Wisconsin estate tax, the circuit court concluded that *Firstar Trust Company v. First National Bank of Kenosha,* 197 Wis. 2d 484, 541 N.W.2d 467 (1995), "deals with the issue completely" and that the Estate's claim that the defendants were obligated to pay a portion of the Wisconsin estate tax generated by the P.O.D. accounts is not maintainable under state law. The circuit court also rejected the Estate's claim for apportionment of estate taxes because no Wisconsin apportionment statute exists and the court declined to create a common-law equitable apportionment rule. As to the Estate Tax Withholding Agreement signed by Mary Jo Schleis and James Schleis and the Estate for the "required estate taxes" to be paid from the P.O.D. accounts, the circuit court concluded that "the so called agreement does not provide a cognizable remedy," because "there is no federal or state withholding procedure" for P.O.D. accounts.

¶5 On appeal from the judgment and order of the circuit court, this court must address four issues: (1) When a decedent dies leaving no will, must a recipient of a P.O.D. account reimburse the Estate for a portion of the federal estate taxes attributable to a P.O.D. account? (2) When a decedent dies leaving no will, must a recipient of a P.O.D. account reimburse the Estate for a portion of the Wisconsin estate taxes attributable to a P.O.D. account? (3) When a decedent dies leaving no will and no Wisconsin statute directs apportionment of estate taxes, does the court apply a common-law limited equitable apportionment rule requiring a recipient of a P.O.D. account to reimburse

the Estate for a portion of the federal and state estate taxes attributable to a P.O.D. account? (4) Does an agreement signed by parents of a minor recipient of a P.O.D. account impose liability on the parents or the minor to reimburse the Estate for a portion of the federal and state estate taxes attributable to a P.O.D. account?

¶6 We conclude that payment of the federal estate tax is to be made by the Estate under 26 U.S.C. § 2002 (2006),[3] which provides that an estate pays the estate tax on nonprobate property. The P.O.D. accounts at issue do not fall within 26 U.S.C. §§ 2207B and 2036 or any other exception to the general rule that an estate pays the federal estate tax generated by nonprobate assets.[4] We further conclude that the Estate must pay the Wisconsin estate taxes generated by the P.O.D. accounts. In Wisconsin the court has applied the burden-on-the-residue rule for state estate taxes unless the testator directs otherwise. The court declines to establish a common-law equitable apportionment rule. Furthermore, the agreement signed by Mary Jo and James Schleis, parents

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[3] All subsequent references to the United States Code are to the 2006 official version unless otherwise indicated.

[4] Probate assets are those transferred by testate or intestate succession; nonprobate assets are those transferred outside of probate, such as life insurance proceeds or jointly held property. For a summary of and illustrations of probate and nonprobate assets, see Katherine W. Lambert, *Death in Wisconsin: A Legal Practitioner's Guide to Postmortem Administration*, § 11.1 (9th ed. 2008).

of Jessica Schleis, to retain 50% of all sums payable on the P.O.D. accounts "for the purpose of paying required estate taxes" is not enforceable against the Schleises. Accordingly, we affirm the order and judgment in favor of the defendants.

I

¶7 For the purposes of this appeal, the facts are not in dispute.[5] James F. Sheppard, the decedent, established two payable on death (P.O.D.) accounts prior to his death. Sheppard designated his god-daughter, Jessica Schleis, as the recipient of these two P.O.D. accounts on his death. James Sheppard died without a will on July 2, 2007, with a total estate valued at approximately $12 million. The P.O.D. accounts designating Jessica Schleis as the recipient were worth approximately $3.8 million at the time of Sheppard's death.[6]

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[5] The circuit court observed that this matter "is not fact-intensive. Although there are likely differences of opinion as to facts, none of them would seem to be material to any issue of law before the Court. There is no genuine issue as to any material fact."

The circuit court also adopted the Estate's "statement of the true controversy: 'The ultimate question in this case is the extent to which the Schleis family collectively will be required to pay their proportionate share of both federal and state estate taxes on two payable on death accounts. . . .'"

[6] The accounts at issue include a "brokerage account" held at M&I Brokerage Services, Inc., which had $1,115,720.44 on deposit at the time of Sheppard's death, and a "Premier Platinum

(Continued on following page)

¶8 Jessica Schleis was a minor, 17 years old, when James Sheppard died. Jessica's mother, Mary Jo Schleis, communicated with the attorney for the Estate on July 19, 2007. The Estate's attorney, who also represents the Estate before this court, advised Mary Jo Schleis that federal and Wisconsin estate tax obligations would attach to the recipient of the P.O.D. accounts.

¶9 At the suggestion of the Estate's attorney and with the advice of their own attorney, Jessica's parents signed, with Jessica's knowledge, an "Estate Tax Withholding Agreement," dated September 3, 2007.[7] The agreement provided that 50% of all sums would remain on deposit in the accounts for the purpose of paying "required estate taxes." The Estate then supplied the Schleis family with information the Estate had regarding the P.O.D. accounts and with two death certificates, and refrained from taking any action to impede Jessica Schleis's ability to withdraw from the accounts.

¶10 Because Jessica Schleis was a minor, her parents petitioned the circuit court on September 13, 2007, to be appointed her guardians.

¶11 As part of the guardianship proceeding, the circuit court appointed a guardian ad litem for Jessica

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Checking Account" held at Chase Bank, which had $2,666,854.59 on deposit.

[7] The Schleises' signatures on the agreement are dated August 31, 2007.

Schleis. The guardian ad litem advised the Estate's attorney that she had advised the Schleis family that Jessica Schleis was not responsible for payment of federal or state estate taxes because the P.O.D. accounts were not part of the residuum of the probate estate and that as guardians of Jessica's estate the Schleises could remove all funds from the P.O.D. accounts.

¶12 On October 30, 2007, Mary Jo Schleis and James Schleis were appointed guardians for Jessica. The Schleises withdrew the entire balance from the P.O.D. accounts on November 12, 2007. While guardianship proceedings were ongoing, the Schleises retained a second attorney who on November 26, 2007, advised the Estate's attorney that she believed the Estate Tax Withholding Agreement was not binding on her clients, Mary Jo and James Schleis.

¶13 On January 17, 2008, the Estate's counsel advised counsel for the Schleises that the Estate maintained the position that Mary Jo Schleis, James Schleis, and Jessica Schleis were responsible to pay their share of all federal and Wisconsin estate taxes and that their obligation was joint and several. The Estate brought this suit seeking reimbursement of estate taxes from Mary Jo Schleis, James Schleis, and Jessica Schleis.

¶14 Jessica Schleis reached the age of majority on February 18, 2008.

II

¶15 In reviewing a circuit court's decision granting summary judgment, this court applies the same methodology as the circuit court.[8] Under Wis. Stat. § 802.08(2), summary judgment must be entered "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law."

III

¶16 The first issue is whether the Internal Revenue Code provides the Estate a right to recover a portion of federal estate taxes from the recipient of a P.O.D. account. We begin with a brief review of the applicable Internal Revenue Code provisions.

¶17 First, 26 U.S.C. § 2002 states that the executor of a decedent's estate shall pay federal estate taxes imposed by 26 U.S.C. § 2001 et seq., whether the taxes are attributable to probate or nonprobate property. Section 2002 simply states, "The tax imposed by this chapter shall be paid by the executor." Section 20.2002-1 of the Regulations elaborates to explain that an executor's or administrator's duty to pay federal estate tax applies to the "entire tax,

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[8] *Pawlowski v. Am. Family Mut. Ins. Co.*, 2009 WI 105, ¶15, 322 Wis. 2d 21, 777 N.W.2d 67.

regardless of the fact that the gross estate consists in part of property which does not come within the possession of the executor or administrator. . . ." 26 C.F.R. § 20.2002-1 (2009). Thus the probate estate (the portion of the estate within the executor's possession) pays all of the federal estate taxes even if a portion of the total tax is generated by property that has passed to a recipient through a nonprobate transfer (such as a P.O.D. account) and did not come under the executor's control or possession.

¶18 Four federal statutory provisions, 26 U.S.C. §§ 2206-2207B, set forth exceptions to the general rule of 26 U.S.C. § 2002 that the probate estate pays the federal estate tax. These four exceptions permit the estate to seek reimbursement for a portion of the federal estate taxes paid from a recipient of a nonprobate asset. The four exceptions are as follows:

Section 2206	Life Insurance Beneficiaries.
Section 2207	Liability of recipient of property over which decedent had power of appointment.
Section 2207A	Right of recovery in the case of certain marital deduction property.
Section 2207B	Right of recovery where decedent retained interest.

¶19 The Estate argues that the last exception, 26 U.S.C. § 2207B, applies in the present case. Section 2207B states that if the value of property is

included in the gross estate on which estate tax has been paid, by reason of 26 U.S.C. § 2036, then the decedent's estate has a right of recovery from the person receiving the property equal to the same ratio that the value of the property bears to the taxable estate. Section 2207B(a) provides as follows:

> Right of recovery where decedent retained interest.
>
> (a) Estate tax.
>
> (1) In general. If any part of the gross estate on which tax has been paid consists of the value of property included in the gross estate by reason of [26 U.S.C. § 2036] (relating to transfers with retained life estate), the decedent's estate shall be entitled to recover from the person receiving the property the amount which bears the same ratio to the total tax under this chapter [26 U.S.C. § 2001 et seq.] which has been paid as –
>
> (A) the value of such property, bears to
>
> (B) the taxable estate.
>
> (2) Decedent may otherwise direct. Paragraph (1) shall not apply with respect to any property to the extent that the decedent in his will (or a revocable trust) specifically indicates an intent to waive any right of recovery under this subchapter with respect to such property.

¶20 To determine whether the Estate has a right of recovery under § 2207B, we must therefore

examine whether the value of the P.O.D. accounts at issue was included in James Sheppard's gross estate pursuant to 26 U.S.C. § 2036. Only if the P.O.D. accounts were included in the gross estate pursuant to § 2036 does § 2207B apply, giving the Estate a right to seek reimbursement from Jessica Schleis for a portion of the estate taxes.

¶21 Section 2036 governs transfers made during a decedent's lifetime in which a decedent retained the right to income from the property or the right to determine who shall receive the property or income from the property. Section 2036(a) provides as follows:

> Transfers with retained life estate
>
> (a) General Rule. The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death –
>
> (1) the possession or enjoyment of, or the right to the income from, the property, or
>
> (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

¶22 Section 2036 applies where a decedent makes "a transfer" by trust or otherwise during his life retaining for his life, or any period not ascertainable without reference to his death, the income or the right to designate the persons who shall possess or enjoy the property or the income. Section 2036 operates to impose a portion of the federal estate tax on property that a decedent transferred during his or her life but in which the decedent retained an economic benefit until his death. *See Helvering v. Bullard,* 303 U.S. 297, 300 (1938); *Hassett v. Welch,* 303 U.S. 303, 310-12 (1938).

¶23 To determine whether the P.O.D. accounts at issue are included in the gross estate under 26 U.S.C. § 2036, we must determine whether the decedent made "a transfer" during his life by creating the P.O.D. accounts.

¶24 Under Wisconsin law governing P.O.D. accounts, the creation of a P.O.D. account does not amount to a transfer of property by the decedent to the recipient during the decedent's life. When a depositor opens a P.O.D. account, he or she names a recipient who is to receive the property in the account at the time of the depositor's death.[9] The depositor is

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[9] The legislature has authorized Wisconsin financial institutions to offer P.O.D. accounts to their customers. *See* Wis. Stat. §§ 705.01(8)-(9), 705.03(2). Wisconsin Stat. § 705.03(2) specifies that "[a] P.O.D. account belongs to the original payee during the original payee's lifetime and not to the P.O.D. beneficiary or beneficiaries." With respect to T.O.D. accounts, Wis. Stat. § 705.26

(Continued on following page)

not required to notify the recipient when the account is opened or when the recipient is named. Wis. Stat. § 705.26. Prior to the depositor's death, the depositor maintains control over the principal and income of the accounts and can change the P.O.D. recipient at any time. The depositor can remove all the assets from a P.O.D. account and close the account at any time before his or her death, without notifying the P.O.D. recipient. The recipient has a right to the account only if the account exists at the death of the depositor and the recipient survives the depositor.

¶25 Section 2036 applies to a transfer with a retained life estate. A property interest must be transferred during the owner's lifetime in order for a life estate to be retained. The P.O.D. account does not constitute such a transfer. During his or her lifetime the depositor is the owner of the P.O.D. account and controls the income, the principal, and the right to decide who gets the property at the depositor's death. With a P.O.D. account the depositor remains the owner during his or her life, transfers nothing during his or her life, and retains total interest in the property during his or her life. The depositor continues to control the principal and the income and could close the account or change the recipient at any time without even notifying the recipient of a change or the existence of the account. The depositor did not

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provides that "[t]he designation of a TOD beneficiary on a registration in beneficiary form does not affect ownership until the owner's death."

transfer any ownership rights or any rights to income during his life.

¶26 The recipient of a P.O.D. account does not possess a remainder interest. The recipient has only the potential expectancy of receiving the proceeds if the depositor makes no change in the nature of the account or in naming the recipient of the account and the named recipient survives the depositor. There is no transfer to the recipient involved in the creation of a P.O.D. account during the decedent's lifetime as required by 26 U.S.C. § 2036.

¶27 The Estate argues for a broad definition of "a transfer" under 26 U.S.C. § 2036 to include the creation of a P.O.D. account.[10] The Estate argues that the ownership right the decedent relinquished was the right to include the P.O.D. accounts in his probate estate. This argument would create an overly broad definition of a transfer. The Estate's definition would appear to require that virtually all nonprobate assets be included under 26 U.S.C. § 2036.

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[10] The Estate suggests that *Doerr v. United States*, 819 F.2d 162, 164 (7th Cir. 1987), provides a definition of "transfer" that would encompass creating and naming the recipients of P.O.D. accounts. *Doerr*, a gift tax case, held that "when a person bestows an economic benefit upon another individual by gratuitously releasing a valuable right as against that individual, the release of that right constitutes a 'transfer of property by gift.'" *Doerr*, 819 F.2d at 164. Here, it cannot be said that when the decedent created the P.O.D. accounts he released any valuable right.

¶28 Arguing that such a transfer does take place, the Estate relies on an Indiana court of appeals case, *Burke v. Cleland,* 702 N.E.2d 1078 (Ind. Ct. App. 1998). The *Cleland* case is not helpful to our analysis. *Cleland* turns on the language of the instruments used by a testator to transfer property to beneficiaries. The Indiana court did not analyze 26 U.S.C. § 2036. It simply stated that an inter vivos trust was included in the gross estate under § 2036.

¶29 In *Cleland,* the testator's will and an inter vivos trust each contained a clause directing the payment of federal estate taxes, and the two clauses were conflicting. The beneficiaries under the inter vivos trust (executed after the will) and the will were different. Conflict arose about who should pay the federal estate taxes generated by the property in the inter vivos trust.

¶30 The Indiana court of appeals held that the last instrument in time, the inter vivos trust, would control when there was an unambiguous tax provision in both a will and an inter vivos trust. The inter vivos trust instrument provided that upon request of the testator's personal representative, the trustee would pay all federal and state death taxes. The Indiana court held that this pay-all-taxes clause rebutted Indiana's presumption of apportionment. Accordingly, the inter vivos trust was responsible for the federal estate tax.

¶31 The analysis in *Cleland,* where a specific provision by the testator provided for payment of

taxes by the trust, does not apply to the present intestate case. The general rule that the residual estate pays the estate tax is not displaced by any instructions of the decedent.

¶32 The Estate relies on other cases holding that the decedent had made a transfer for purposes of 26 U.S.C. § 2036. For example, the Estate refers to *Estate of Morton v. Commissioner of Internal Revenue*, 12 TC 380 (1949), in which the election of a settlement option by a surviving spouse under the terms of a life insurance contract was determined to be a transfer during her lifetime that brought the proceeds within her gross estate at the time of her death. The spouse was entitled to the proceeds of the policy but elected to leave the proceeds with the insurer, receiving income with a right to invade the remainder, and naming a recipient who would receive the money on her death. The issue was whether the proceeds were included in the gross estate of the spouse even though she had not elected to receive the lump sum during her lifetime. The court considered that the spouse had made a transfer of the assets.

¶33 Another example provided by the Estate is when a decedent set up a bank account in his name as a trustee for specified recipients, sometimes called a savings account trust (or "Totten Trust"). *Estate of Sulovich v. Comm'r of Internal Revenue*, 587 F.2d 845 (6th Cir. 1978). The decedent gave the passbook to the parent of the recipients and authorized the withdrawal of funds. Under banking rules, the decedent retained full income and remainder rights to

the account. The issue was whether the funds should be included in the decedent's gross estate, not the applicability of § 2207B for apportionment of estate taxes. The court held that the decedent had not completed a gift of the assets, but that the decedent had made a transfer of the assets under either 26 U.S.C. § 2036 or § 2038, and that the assets were therefore included in the gross estate.[11]

¶34 These fact patterns are different from the P.O.D. accounts where the accounts remained titled in the decedent's sole and individual name. The cases relied upon by the Estate are inapposite.

¶35 We conclude that creation of the P.O.D. accounts did not fall within the meaning of a transfer under 26 U.S.C. § 2036, and therefore the estate does not have a right to recover under 26 U.S.C. § 2207B. Because §§ 2207B and 2036 do not apply, the general rule of 26 U.S.C. § 2002 applies: the residual estate pays the federal estate taxes on the P.O.D. accounts. The P.O.D. accounts are therefore not required to pay any portion of the federal estate taxes.

IV

¶36 Next, we turn to whether a recipient of a P.O.D. account must reimburse an Estate for a

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[11] *See also Estate of Bowgren v. Comm'r of Internal Revenue*, 105 F.3d 1156, 1160 (7th Cir. 1997) (decedent created an Illinois land trust retaining interests during life; property included in gross estate under either 26 U.S.C. § 2036 or § 2038).

portion of the Wisconsin estate taxes attributable to the P.O.D. account when a decedent dies with no will. The answer is No.

¶37 We agree with the circuit court that *Firstar Trust Co. v. First National Bank of Kenosha*, 197 Wis. 2d 484, 541 N.W.2d 467 (1995), controls. Under *Firstar Trust*, the residue of the estate pays the Wisconsin estate taxes attributable to nonprobate property in the absence of clear directions from the testator providing otherwise.

¶38 The Estate does not separately brief the issue of liability for the Wisconsin estate tax. We conclude that under *Firstar Trust*, the Estate's claim against the Schleises for a portion of the state estate tax cannot be maintained under Wisconsin law.

V

¶39 The third issue is whether a common-law rule of limited equitable apportionment exists, requiring a recipient of P.O.D. accounts to reimburse an estate for a portion of the federal and state estate taxes attributable to the P.O.D. accounts when a decedent dies leaving no will.

¶40 Generally, if a decedent does not specify who pays federal or state estate taxes or does not do so effectively, state law will determine how to apportion the payment of federal and state estate taxes

among the various beneficiaries.[12] Several states have enacted statutes that determine which beneficiaries will pay federal and state estate taxes. Many states' statutes require recipients of nonprobate assets to pay their pro rata share of the federal and state estate taxes. State courts have also created equitable apportionment remedies that accomplish the same result as an apportionment statute.

¶41 Wisconsin does not have an apportionment statute that directs the apportionment of federal or state estate taxes among various beneficiaries when a will or trust does not provide direction.

¶42 In response to the Estate's request that the circuit court adopt an apportionment rule, the circuit court declared that "[t]here is no basis either statutorily or in the case law which would give the Court the confidence to create a remedy. More importantly, that is the province of the Supreme Court, not this Circuit Court especially under these facts. The [Estate] is asking the Court to stand the system on its head. It is the probate estate that pays the estate and inheritance taxes. To suggest that this obligation should be distributed to P.O.D. and similar accounts would have a serious negative impact on the administration of probate, generally; there would be tax

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[12] *Riggs v. Del Drago*, 317 U.S. 95, 97-99 (1942) (the Internal Revenue Code allocates the federal estate tax burden in certain circumstances; state law generally controls the thrust of the federal estate tax liability).

obligations flowing outside of the classic probate process."

¶43 We examine three Wisconsin cases that discuss an equitable apportionment rule: *Will of Uihlein,* 264 Wis. 362, 59 N.W.2d 641 (1953); *Estate of Joas,* 16 Wis. 2d 489, 114 N.W.2d 831 (1962); and *Firstar Trust Co. v. First National Bank of Kenosha,* 197 Wis. 2d 484, 541 N.W.2d 467 (1995). None of the cases adopts or applies an equitable apportionment of estate taxes.

¶44 In *Uihlein,* the widow of the decedent chose to take her statutory one-third share of the estate rather than to take her share under the will. The widow claimed her statutory one-third share was to be calculated before federal estate taxes were paid. The effect of the widow's claim was to shift the burden of the federal estate tax to the remainder of the estate, making her share of the estate larger.

¶45 The *Uihlein* court likened the federal estate tax to debts and expenses of administration that are to be paid by the residue before calculating the widow's share. The court rejected equitable apportionment of the federal estate tax as "unwarranted judicial legislation." *Uihlein,* 264 Wis. at 376. The court stated that "[t]his court in *Will of Kootz* [228 Wis. 306, 280 N.W. 672 (1938)] rejected the theory that our court should invoke its equity powers to achieve an apportionment of federal estate taxes which would prevent inequities. . . . We deem that it would be unwarranted judicial legislation for this court to attempt to apportion the impact of the federal estate

tax. . . . The legislature has the power to enact an apportionment of federal estate tax statute providing for a different method of bearing the impact of federal estate taxes if it should determine the same desirable." *Uihlein*, 264 Wis. at 374, 376.

¶46 In *Joas*, this court considered who should pay the federal estate and Wisconsin inheritance tax relating to joint property. The will declared that the estate would pay all taxes for property that passed under the will. Because the joint property was nonprobate property, that is, the property did not pass to the recipients under the will, the court held that the will's provision allocating taxes did not apply to the joint property. The court applied Wisconsin law, placing the burden of paying the federal estate tax attributable to the joint property on the residuum of the probate estate. The court declined to create an equitable apportionment rule.[13]

¶47 Finally, in *Firstar Trust*, the court addressed the issue of whether the residue of the estate or a trust bore the burden of the portion of the Wisconsin estate tax generated by the trust property. The court held that the burden of the state estate tax was to be borne by the decedent's probate estate and that the

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[13] The Wisconsin inheritance tax was at that time a tax on the right to receive the property unless the decedent made some other provision in the will. Because the will's tax clause did not cover nonprobate property, the inheritance tax was payable by the surviving joint tenant who received the property. *Joas*, 16 Wis.2d at 492.

estate was not entitled to reimbursement from the trust for Wisconsin estate taxes paid. The court reviewed and reaffirmed prior Wisconsin case law, refusing to recognize equitable apportionment of Wisconsin estate taxes, stating: "Although some states have altered the burden-on-the-residue rule by statutory or judicially-created apportionment rules, Wisconsin is among the states that have not done so." *Firstar Trust,* 197 Wis. 2d at 510. As noted there, "This court has consistently rejected the notion of judicially legislated estate tax apportionment rules." *Firstar Trust,* 197 Wis. 2d at 509 n. 15.

¶48 The Estate argues that *Will of Cudahy,* 251 Wis. 116, 28 N.W.2d 340 (1947), controls to make apportionment of the estate tax burden applicable to nonprobate property. The Estate misinterprets *Cudahy.*

¶49 The issue in *Cudahy* was the interpretation of the decedent's will and inter vivos trust. *Cudahy* involved property passing under an inter vivos trust, the terms of which directed the trustee to pay all taxes on the trust property. At the same time, the decedent's will directed the executors to pay "just debts, funeral expenses and all inheritance, estate and succession taxes." The question was which entity, the trust or the estate, should pay Wisconsin inheritance taxes generated by the transfer of the decedent's interest in the trust. The court concluded that the will did not manifest the decedent's intention to provide for the payment of the taxes attributable to the beneficiaries of the trust estate, nonprobate

property. The court ruled that the trust should pay the inheritance taxes; the trust disposed of the property and the trust instrument made provision for payment of taxes thereon. *Cudahy,* 251 Wis. at 120-21.

¶50 The *Cudahy* court did not hold that nonprobate assets should pay a share of inheritance taxes attributable to those assets. *Cudahy* was an interpretation of the decedent's intentions expressed in written documents, not an adoption of Wisconsin tax apportionment law. *Cudahy* is not instructive for the present case.

¶51 The Estate asks this court to recognize a common-law equitable apportionment doctrine to prevent injustice to heirs of James Sheppard and to prevent Jessica Schleis from getting a windfall. The Estate views the rule of limited equitable apportionment as promoting fairness and equality.

¶52 Wisconsin does not have an apportionment statute. Wisconsin case law declines to recognize an equitable apportionment rule. The precedent is clear: In the absence of a statute or a decedent's written directions, in Wisconsin the burden of the federal and state estate taxes attributable to probate and nonprobate assets falls on the residue of the estate. The rationale for the "residuary rule" has generally been that the decedent intended property transferred

outside probate to be free of the usual burdens imposed on the probate estate.[14]

¶53 The burden of the federal and Wisconsin estate taxes in the instant case falls on the residue of the estate where the law has placed it. If apportionment is to be the policy of the state, then the state legislature should adopt it.

VI

¶54 The final issue relates to the Estate Tax Withholding Agreement signed by Mary Jo Schleis, James Schleis, and the Estate. The Schleises agreed that 50% of the balance of the P.O.D. accounts would remain on deposit "for the purpose of paying *required estate taxes*" (emphasis added). The Agreement further provides that "[i]n the event excess sums have been withheld, these monies will be distributed within 30 days following the filing of estate tax returns." The Agreement does not state that Jessica Schleis is required to pay a certain amount or portion of estate taxes. The entire text of the agreement reads as follows:

> The parties agree that 50% or one-half of all payable on death accounts owned by James F. Sheppard at the time of his death will remain on deposit with the bank for the purpose of paying required estate taxes.

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[14] *In Estate of Mason*, 190 Ariz. 312, 947 P.2d 886, 889 (Ariz.Ct.App.1997).

> In the event excess sums have been withheld, these monies will be distributed within 30 days following the filing of estate tax returns.

¶55 The Estate asks the court to hold that this Agreement obligates Jessica Schleis and her parents to pay a portion of the estate tax, even without determining as a prerequisite that Jessica owed any estate tax.

¶56 The circuit court concluded that there is no contract binding Jessica Schleis "and further the so called agreement does not provide a cognizable remedy. There is no federal or state withholding procedure for such accounts."

¶57 The Agreement refers to "required taxes." The Schleises have no "required taxes." Because the P.O.D. accounts are not required to pay any estate taxes under federal or Wisconsin estate tax law, the Agreement creates no obligation to pay required taxes. This two-sentence document cannot be interpreted to create an independent obligation on the part of the Schleises to pay a share of estate taxes that neither they nor their daughter owed.

¶58 Furthermore, Jessica did not sign the agreement and is not a party to it. The document does not suggest that Mary Jo Schleis and James Schleis are signing in any capacity other than personally for themselves. No guardian had been appointed for Jessica, who was a minor when the Agreement was signed. Jessica is not liable for the taxes, and a

guardian would not be authorized to make a gift of the taxes to the Estate without express court approval. Wis. Stat. § 54.20(2)(a).

¶59 The Estate argues the Agreement is binding because Jessica did not disavow it. No agreement was made on Jessica's behalf, so there was nothing for her to disavow. Furthermore, Jessica's guardian ad litem did advise the Estate of the intent to disavow any purported agreement. By letter dated October 10, 2007, Jessica's guardian ad litem advised the Estate that under Wisconsin law, "the estate taxes would be paid out of the residue of Mr. Sheppard's estate," and that "Mr. & Mrs. Schleis cannot enter a contract regarding their daughter's money." Jessica's position has been consistent: she is entitled to all the proceeds of the P.O.D. accounts and has no obligation to pay the estate taxes.

¶60 The Estate claims the result is unjust and unfair and imposes an undue burden on James Sheppard's heirs who take through the probate estate. Federal and state law have determined where the tax liabilities fall. There is no equitable basis to impose a constructive trust as a matter of law. James Sheppard could have directed a different result but he did not.

¶61 In sum, for the reasons we set forth, we conclude that payment of the federal estate tax is the burden of the Estate under 26 U.S.C. § 2002, which provides that an estate pays the estate tax on nonprobate property. The P.O.D. accounts at issue do not

fall under 26 U.S.C. §§ 2207B and 2036 or any other exception to the general rule that an estate pays the federal estate tax generated by nonprobate assets. We further conclude that the Estate must pay the Wisconsin estate taxes generated by the P.O.D. accounts. In Wisconsin, the court has applied the burden-on-the-residue rule for state estate taxes unless a testator directs otherwise. The court declines to establish a common-law equitable apportionment rule. Furthermore, the agreement signed by Mary Jo and James Schleis, parents of Jessica Schleis, to retain 50% of all sums payable on the P.O.D. accounts "for the purpose of paying required estate taxes" is not enforceable against the Schleises.

¶62 Accordingly, we affirm the circuit court's order and judgment in favor of the defendants.

By the Court. – The order and judgment of the circuit court are affirmed.

STATE OF WISCONSIN | CIRCUIT COURT | WASHINGTON COUNTY

ESTATE OF JAMES F. SHEPPARD,

Plaintiff,

vs.

JESSICA SCHLEIS, et al.,

Defendant.

DECISION

Case No. 08CV1122

The defendants Jessica Schleis, James Schleis and Mary Jo Schleis brought a Motion for Summary Judgment. Although not explicitly brought on behalf of the fictional defendant, "XYZ Financial Institutions," granting of the motion certainly dismisses that fictional claim as well.

As the defendants point out, summary judgment is a statutory standard. They cite Wisconsin Statutes § 802.08(2). The Supreme Court in *Liebovich v. Minnesota Insurance Company*, 2008 WI 75, ¶ 14, 310 Wis. 2d 751, 765, 728 N.W.2d 357, restates the well known standard as follows:

> "A motion for summary judgment may be granted only when the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law," (Internal citations and quotations omitted.)

This motion is not fact-intensive. Although there are likely differences of opinion as to facts, none of them would seem to be material to any issue of law before the Court. There is no genuine issue as to any material fact.

The Court will adopt the statement of the case as provided in defendant's brief in support of its motion. It is a quick summary of the state of the case. Similarly, the Court finds the first paragraph of the estate's response to be a handy statement of the true controversy:

> "The ultimate question in this case is the extent to which the Schleis family collectively will be required to pay their proportionate share of both federal and state estate taxes on two payable on death accounts, both of which named Jessica Schleis as the ultimate beneficiary."

The Court agrees with the defense that the obligation to pay estate and inheritance taxes rests on the estate and the personal representative, not the defendants. The law is quite clear in this matter. The Court does appreciate that the estate believes it is equitable for all "beneficiaries" to share equally in the tax burden but this is not necessarily the law nor does it result in any inequity.

The Court does not consider the legal issues in this case to be a close call. The defense is clearly right. For example, 22 U.S.C, section 202 provides that the tax is to be paid by the estate. The regulations cited

by the defense in its reply brief further clarify that this duty pertains not just to the estate being probated but also to portions of the decedent's property not passing through probate. Similarly, as to any Wisconsin tax due, the Court agrees that *Firstar Trust Company v. First National Bank of Kenosha*, 197 Wis. 484, 541 N.W.2d 467 (1995) is on point and deals with the issue completely. The estate's first claim is not maintainable under federal or state law.

As to the second claim, the Court is unclear as to what equities would apply. The claim would require the Court to create a common law equitable apportionment remedy. There is no basis either statutorily or in the case law which would give the Court the confidence to create a remedy. More importantly, that is the province of the Supreme Court, not this Circuit Court especially under these facts. The plaintiff is asking the Court to stand the system on its head. It is the probate estate that pays the estate and inheritance taxes. To suggest that this obligation should be distributed to P.O.D. and similar accounts would have a serious negative impact on the administration of probate, generally; there would be tax obligations flowing outside of the classic probate process. For example, as a practical matter how would an estate get a closing certificate from the Department of Revenue when taxes are payable by third parties outside the control and responsibility of the estate, such as the beneficiary of a P.O.D. account.

On the third claim, the Court again agrees with the defense that there is certainly no contract binding

Jessica Schleis and further the so called agreement does not provide a cognizable remedy. There is no federal or state withholding procedure for such accounts.

With respect to promissory estoppel, the defense has correctly stated those elements necessary to establish such a claim. *Hoffman v. Red Owl Stores, Inc.*, 26 Wis. 2d 683, 133 N.W.2d 1965. The estate's attempt to find an injustice by positing a duty on recipients which is not founded in state and federal law can be no basis for an action in equity.

The defendant's reply brief deals with the causes of action contained in an amended complaint. The Court fails to see how unjust enrichment could generally apply to any transfer on death, whether directly through probate or by some other disposition such as a P.O.D. account. These transfers of assets are a gratuity based on the decedent's (or testator's) beneficence or ill-will. There may be a sort of quid pro quo, but that is not the nature of these transfers. By way of further example, in a typical estate it does not matter if one heir at law is treated better than other similar heirs at law. It means nothing that P.O.D. accounts have "diverted" assets from the estate. The primary focus is on the testator's intent. Furthermore, the Court agrees with the defense that there can be no unjust result where tax liabilities fall where the law places them. Similarly there is no basis for any recovery as a "necessary" or constructive trust. There is no wrongful deprivation of money. Jessica Schleis owes no obligation directly under the law.

In conclusion, the defense is entirely correct that this matter is not only appropriate for summary judgment but, as a matter of law, it is entitled to summary judgment. If the estate has suffered any loss, it is not due to the action of the defendants but rather to James F. Sheppard's. However, in fact, there is no loss since the burden falls where the law has placed it.

This is dismissed. The defendants are directed to prepare an order consistent with this decision.

Dated this 24 day of February, 2009.

BY THE COURT:

/s/ P.J.F.
Honorable Patrick J. Faragher
Circuit Court Judge, Branch I

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The court has entered the following order:

District: 2
Appeal No. 2009AP001021

Date: June 10, 2010
Circuit Court Case No. 2008CV001122

Estate of James F. Sheppard v. Jessica Schleis

The court having considered the **Motion for Reconsideration** filed in the above matter,

IT IS ORDERED that the Motion for Reconsideration is denied, with $50.00 costs.

David R. Schanker
Clerk of Supreme Court

STATE OF WISCONSIN
COURT OF APPEALS

DISTRICT II
NO. 2009AP001021

ESTATE OF JAMES F. SHEPPARD,
by its Co-Personal Representative,
MICHAEL E. MCMORROW,

Plaintiff-Appellant,

v.

JESSICA SCHLEIS,
JAMES SCHLEIS,
MARY JO SCHLEIS,
and XYZ FINANCIAL INSTITUTIONS,

Defendants-Respondents.

ON APPEAL FROM THE DECISION AND ORDER OF THE WASHINGTON COUNTY CIRCUIT COURT DATED FEBRUARY 24TH, 2009 AND MARCH 24TH, 2009, RESPECTIVELY, THE HONORABLE PATRICK J. FARAGHER PRESIDING

BRIEF OF PLAINTIFF-APPELLANT

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PUBLICATION AND ORAL ARGUMENT

The decision will be appropriate for publication in that the rules of law expressed have State-wide impact. Oral argument is required as the issues are both complex and of first impression.

STATEMENT OF THE ISSUES

I. Does IRC §2207B require Jessica Schleis to reimburse the estate for Federal Estate Tax liability incurred on payable on death accounts?

The trial court failed to answer this question.

II. As the decedent died *intestate*, does the doctrine of limited equitable apportionment require Jessica Schleis to reimburse the Estate

for *both* Federal and Wisconsin Estate Tax liability incurred on non-probate property?

The trial court deferred to the Wisconsin Supreme Court on this issue.

III. Is Jessica Schleis's agreement to pay her proportionate share of Federal and Wisconsin Estate Taxes enforceable either in law or in equity?

The trial court found no legal or equitable obligation.

* * *

II. As Sheppard died intestate, the doctrine of limited equitable apportionment likewise demands that Jessica Schleis reimburse the estate for both Federal and Wisconsin Estate Tax Liability incurred on the non-probate, POD Account proceeds.

In the event the Federal Statute is for any reason found inapplicable, the Appellant requests the court to prevent the *injustice* to some heirs and a windfall to Respondent Jessica Schleis through the application of the doctrine of limited equitable apportionment to the POD Accounts. *Carpenter v. Carpenter,* infra @ p 642; Annot. 68 ALR 3rd 714, 727.

In this analysis, it is first necessary to consider that the Federal and Wisconsin Estate Tax both contemplate *but one estate* and that Estate Taxes are levied upon the whole of the "*taxable estate*". *Wis. Stats.* §72.02. However, the *probate* estate and the

non-probate estate are, in fact, separate entities; the former being the decedent's true estate of which he or she may dispose of by will or through intestacy, while the latter is not subject to testamentary disposition.

This artificial concept of the two as a single taxable estate, while convenient for the purpose of the estate tax calculation, does not diminish the separate identity of each estate. *Myers v. Sinkler*, 235 S.C. 162, 110 S.E. 2nd 241, 247 (1959); Annot. 68 ALR 3rd 714, §11(a). By virtue of this convenience, *non-probate property* is included in the taxable estate but is excluded from the probate

* * *

STATE OF WISCONSIN SUPREME COURT

Estate of James F. Sheppard, by its Co-Personal Representative, Michael E. McMorrow,

Plaintiff-Appellant,

-vs-

Jessica Schleis, James Schleis, Mary Jo Schleis, and XYZ Financial Institutions,

Defendants-Respondents

Case No. 2009-AP-1021

RESPONSE TO THE ESTATE'S MOTION FOR RECONSIDERATION

This submission, on behalf of Schleis, opposes the Estate's Motion for Reconsideration. The Estate's Motion for Reconsideration should be denied.

Preliminary Statement

Mr. James Sheppard named his goddaughter, Jessica Schleis, as beneficiary on two accounts: one payable on death (POD), and the other transfer on death (TOD). (Referred to as "POD account.") The Sheppard Estate initiated legal action against Schleis on a number of grounds seeking an order for Schleis to contribute to the estate taxes owed by this Estate. The Circuit Court dismissed the action on Motion for Summary Judgment. The Supreme Court, on bypass from the

* * *

inclusion.

The Estate's Motion uses the phrase 'incomplete transfer' as if it were a new argument. It is not. The whole point of 26 U. S. C. §2036 is to make incomplete transfers subject to estate taxes at death. Were the transfer 'completed,' the transfer would be a gift. The gifted assets would no longer belong to the estate and would no longer be subject to estate tax. When transfers are made and the donor retains too many rights, the transfer becomes 'incomplete.' The estate tax goal of §2036 is to include the assets when the donor has retained too much in terms of control or rights in his or her taxable estate. Obviously, the scope of the section is to bring in assets which have been the subject of a transfer.

POD accounts, which do not constitute transfers, are subject to estate tax because they are owned by the deceased person under 26 U.S.C. §2033.

Citations to Authority in Estate's Motion Do Not Support Estate's Arguments

The Estate misses the point that no transfer takes place in a POD situation. The cases on which the Estate relies all arise in situations where a title transfer has taken place, making them factually and legally different from a POD account. This Court's Decision pointed out the failure of the Estate's cases to support its contention:

These fact patterns are different from the P.O.D. accounts where the accounts remain titled in the decedent's sole and individual name. The cases relied upon by the Estate are inapposite. *Estate of James Sheppard v. Schleis,* 2010 WI 32, ¶34.

* * *

STATE OF WISCONSIN | CIRCUIT COURT PROBATE DIVISION | WASHINGTON COUNTY

ESTATE OF JAMES F. SHEPPARD,

Plaintiff,

vs. Case No. 08-CV-1122

JESSICA SCHLEIS,
JAMES SCHLEIS,
MARY JO SCHLEIS and
XYZ FINANCIAL INSTITUTION

Defendants.

ESTATE'S BRIEF IN RESPONSE TO DEFENDANTS' MOTION FOR SUMMARY JUDGMENT
January 27th, 2009

I. INTRODUCTION

The ultimate question in this case is the extent to which the Schleis family collectively will be required to pay their proportionate share of both federal and state estate taxes on two payable on death ("P.O.D.") accounts, both of which named Jessica Schleis as the ultimate beneficiary.

The Estate asserts that the Schleis family's contention that the estate tax burden on this non probate property is to be placed on the residue of the *probate* estate is both *false* and *erroneous*.

Conversely, the Estate's position that the P.O.D. accounts are to bear their proportionate share of the estate tax burden is required on multiple, yet independent grounds.

* * *

Seventh, Mary Jo Schleis and James Schleis were acting as de facto guardians, custodians and agents when they entered into the Agreement on Jessica's behalf or alternatively, have independent liability for necessities.

Eighth, the analysis by the Wisconsin Supreme Court in the ***Will of Uihlein***, infra, a probate estate case, has since been clarified. In ***Uihlein***, the Court looked to the states of Illinois and North Carolina in concluding that estate taxes attributable to *probate property* should be paid by the residual of the estate. Subsequent to the ***Uihlein*** decision, both Illinois and North Carolina have confirmed that *non-probate property* is required to pay its proportionate share of estate taxes. ***Cornwell***, supra; ***Gowling***, supra.

B. A Federal Right To Reimbursement Exists Under I.R.C. § 2207B

Under Wisconsin law, in absence of a clear intention of contrary intent or federal tax law, the estate tax burden is left where the law places it. *See* ***Firstar***, 197 Wis.2d at 503, 541 N.W.2d at 474 (*citing* ***In re Estate of Joas***, 16 Wis. 2d 489, 491, 114 N.W.2d 831, 833 (1962)).

Federal law generally defers to state law on tax apportionment issues. *See* I.R.C. §§ 2202 and 2205. However, there are four Code sections under the Internal Revenue Code which specifically provide for the right of recovery for federal estate tax imposed on specific non-probate property. *See* I.R.C. §§ 2206 through 2207B.

In ***Firstar***, the Court held that the beneficiaries of a qualified terminable interest property ("QTIP") trust were required under I.R.C. § 2207A to contribute their share of estate taxes attributable to the inclusion of the QTIP trust assets in the deceased spouse's estate. *See* ***Firstar***, 197 Wis.2d at 504-05, 541 N.W.2d at 475. Here, the plaintiff seeks a corresponding remedy under I.R.C. 2207B.

* * *

C. With Respect to P.O.D. Accounts (Non-Probate Property), the Doctrine of Equitable Apportionment Requires Contribution by Jessica Schleis to Both Wisconsin and Federal Estate Tax Obligations:

As previously stated, a right of reimbursement of the federal estate tax attributable to the P.O.D. accounts exists under I.R.C. §2207B. However, should the Court find that this is not the case, the Estate is entitled to relief under the Doctrine of Equitable Apportionment. This Doctrine also applies to the Wisconsin estate tax.

The Estate of James F. Sheppard asserts that under Equitable Apportionment principles, Jessica Schleis, as the recipient of the P.O.D. accounts under scrutiny, being exclusively non-probate property, must pay her proportionate share of the estate taxes imposed by virtue of P.O.D. inclusion in the taxable estate while being at the same time excluded from the probate estate of the decedent.

It is uncontroverted that the two P.O.D. accounts constitute non-testamentary, non-probate property. (Defendants' Answer, ¶ 8) As a consequence, the P.O.D. accounts, like life insurance, pass directly to Jessica Schleis without probate court or personal representative supervision. They are not subject to administration as no confirmation of transfer is required, no inventory filing fee is paid on their value, and they will never come into the hands of the Personal Representatives. (*Wis. Stats.* §705.10(4), §705.04(2), §705.27, §851.01, §814.66(1)(a)(3))

The defendants contend that absent a contrary direction from the decedent, the estate residual in all cases should be responsible for the payment of federal estate taxes on P.O.D. accounts. The defendants are in error.

Once again, the Estate asserts that it is in part the distinction between probate and non-probate property which determines the estate tax obligations. Moreover, the legal

* * *

STATE OF WISCONSIN | CIRCUIT COURT PROBATE DIVISION | WASHINGTON COUNTY

ESTATE OF JAMES F. SHEPPARD,

Plaintiff,

-v-

JESSICA SCHLEIS,
MARY JO SCHLEIS,
JAMES SCHLEIS,

-and-

XYZ FINANCIAL INSTITUTIONS,

Defendants.

CASE NO.: 2008-CV-1122

AFFIDAVIT OF MICHAEL E. MCMORROW IN RESPONSE TO DEFENDANTS' MOTION FOR SUMMARY JUDGMENT
January 27th, 2009

STATE OF WISCONSIN)
) ss.
OZAUKEE COUNTY)

I, Michael E. McMorrow, being first duly sworn on oath, state as follows:

1. I am the Co-Personal Representative and one of the attorneys for the Estate of James F. Sheppard. I make this evidentiary affidavit on first hand knowledge.

2. James F. Sheppard died intestate on July 2, 2007. On July 19, 2007, Mary Jo Schleis contacted the Affiant by telephone. At that time, Affiant had been selected to act as attorney for the Estate by Carl Tomasello, the consensus Personal Representative, as well as by all known heirs. During this phone call, Mary Jo Schleis was specifically

* * *

18. Prior to withdrawal, neither Jessica Schleis, James Schleis, Mary Jo Schleis, Attorney Iggens, nor Attorney Shanebrook advised your Affiant that the $3.8 million on deposit in the two payable on death accounts under scrutiny were being entirely withdrawn.

19. To date, the Estate of James F. Sheppard has paid $1,444,597 in federal and state estate tax, $1,000,000 to the Wisconsin Department of Revenue, and $444,597 to the IRS (Department of Treasury). The two P.O.D. accounts naming Jessica Schleis as beneficiary generated a combined estate tax liability of $1,571,354. The entire Wisconsin estate tax obligation has been paid in full and the estate owes an additional $3,202,383 in federal tax with the entire federal tax liability being $3,646,980. The Estate is seeking reimbursement and/or contribution from James Schleis, Mary Jo Schleis and Jessica Schleis in the total amount of $1,571,345 being $1,231,220 in federal tax and $340,125 in Wisconsin estate tax.

20. That Affiant has conferred with the Register of Probate for Chippewa County and has determined

that the joint tenancy real property which was the property under scrutiny in the ***Estate of Joas***, was both inventoried and specifically made part of the court's final judgment. (See Exhibits 24 & 25 attached hereto as public records)

21. That by virtue of subpoena duces tecum, your Affiant has secured a copy of the "Individual Transfer on Death Account Agreement" relating to the M&I brokerage account #3BA-252041. Therein, it provides as follows:

> "In the event that any beneficiary is a minor in the relevant jurisdiction at the time of receipt of notice of my death and Pershing is notified of such fact, the shares *shall be transferred to a custodial account or* other fiduciary *or* guardianship account for the benefit of the minor beneficiary upon receipt of appropriate documentation." (See Exhibit 11 attached) (Emphasis added)

* * *